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PACIFIC TELESIS
Group-Washington

March 26, 1997

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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

Dear Mr. Caton:

Re: *CC Docket No. 96-254 - Implementation of Section 273 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996*

On behalf of Pacific Telesis Group, please find enclosed an original and six copies of its *"Reply Comments"* in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,

Denice Harris

Enclosure

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of Section 273 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996	CC Docket No. 96-254

REPLY COMMENTS OF PACIFIC TELESIS GROUP

I. SUMMARY

The Commission should interpret Section 273 consistently with the deregulatory intent of Congress in enacting the Telecommunications Act of 1996. Thus, the FCC should:

- Limit Section 273's scope to BOCs actually engaged in manufacturing;
- Allow BOCs to continue to develop specifications for their equipment, even if they do so in informal consultation with other BOCs, because such activities promote innovation and interoperability and lower the cost of telecommunications equipment;
- Define "manufacturing" to exclude "design and development" activities since Congress expressly authorized such activities;
- Construe the nondiscrimination provisions of Section 273(e) narrowly; and
- Hold that 273(d) will not apply to Bellcore once it is sold.

II. NONE OF SECTION 273'S PROVISIONS APPLY TO NON-MANUFACTURING BOCS

Congress did not intend to impose Section 273's restrictions on BOCs not engaged in manufacturing. If a BOC sticks to the *status quo* and does not begin manufacturing, it should not be subject to an *entirely new,* burdensome set of Section 273 regulations. Thus, commenters who seek to

impose heavy burdens on all BOCs regarding network disclosure (47 U.S.C. § 273(c)) and procurement (§ 273(e)), for example, must be rejected. Requiring BOCs to adhere to such regulation would produce the opposite result of what the Telecommunications Act intended: it would *increase,* rather than *decrease,* regulation for BOCs that are not engaged in manufacturing. This anomalous result must not come to pass.

Several commenters agree with us that Section 273 only applies to manufacturing BOCs. Northern Telecom at 13, SBC at 8, BellSouth at 25, Ameritech at 7, US West at 18. The Telecommunications Industry Association ("TIA") urges, to the contrary, that limiting the section's application to manufacturing BOCs "could lead the BOCs to withhold information that would otherwise be subject to disclosure until they receive . . . authorization [to manufacture]." TIA at 20. This argument assumes, erroneously, that all BOCs will engage in manufacturing. Some may never do so. Moreover, the statute is entitled "Manufacturing by Bell Operating Companies," and should only apply when, and not before, a BOC is engaged in the activity to which the statute, on its face, applies.

TIA also argues that "applying [Sections 273(c) and (e)] only to BOCs authorized to manufacture under Section 273(a) could encourage BOCs that are not so authorized to discriminate in favor of non-"affiliate" manufacturers in which they have a financial interest." TIA at 46 (re Section 273(e)), 20 (re Section 273(a)). TIA never explains how or why such conduct might occur.

In fact, TIA's argument is irrational. A manufacturer would be a BOC affiliate if the BOC owned 10% or more of the manufacturer's equity. 47 U.S.C. § 3(a)(33). TIA is therefore assuming that a BOC would discriminate in purchases in favor of a manufacturer in which the BOC owned less than 10% of the equity. It is not discriminatory to purchase from the manufacturer who offers the best value in terms of "price, quality, delivery, and other commercial factors." 47 U.S.C.

§ 273(e)(2). TIA is therefore assuming that a BOC would take a product that is not the best value from a manufacturer in which the BOC owned less than 10% of the equity. However, it would be economically irrational for a BOC to benefit a business in which it has an interest of less than 10% by imposing higher costs or substandard products on a business in which it has an interest of 100%. TIA's hypothesis must therefore be rejected.

III. BOCS MUST BE ALLOWED FREEDOM TO DETERMINE THEIR EQUIPMENT NEEDS WITHOUT BEING SUBJECT TO SECTION 273'S STANDARDS-SETTING PROVISIONS

BOCs must be allowed to develop requirements for the equipment they will purchase, even if they do so in collaboration with other BOCs, without having to comply with Section 273's standards-setting provisions. Several commenters demonstrate the benefits that accrue from such collaboration. SBC states, "[t]he Commission should not interpret Section 273(d)(4) so as to preclude joint purchasing alliances. These alliances are formed in order to *obtain better prices based upon aggregate volume purchases.*" SBC at 14 (emphasis added). SBC goes on to state that "it would be unreasonable to construe Section 273(d)(4) to require a large carrier to publicly divulge the attributes it desires in a product . . . which it develops with its selected manufacturer *in order to meet its individual needs.*" *Id.* at 15 (emphasis added).

BellSouth echoes these sentiments: "Broadening [the] application [of Section 273(d)] will slow or thwart the development of interoperable networks and functionalities and impose substantial unnecessary costs on telecommunications and related markets, such as computing, that develop common technical solutions." BellSouth at 19. BellSouth urges the Commission to apply the standards-setting provision "only to legal entities and not to informal groups. . . . The FCC needs to account for the effect its definition of 'entity' could have on the hundreds of formal and informal

bodies involved in developing standards and technical solutions for telecommunications networks." *Id.* at 20. *Accord* Ameritech at 25 (urging Commission to construe Section 273(d)(4) narrowly).

It is also important to note that the BOCs are often trying to obtain breakthrough products from manufacturers. These are products that exceed the capabilities of existing equipment in terms of capacity, speed, functionality and the like. These products often require large and high risk investments in unproved technologies. Manufacturers will not assume such risk unless they are satisfied that substantially similar products can be sold in sufficientquantitiesto recover their development costs and a reasonable rate of return.

Since a single BOC's purchases are often insufficient inducement for such innovation, the deployment of innovative equipment in BOC networks could be stifled or unreasonably delayed by an FCC rule that makes it difficult for BOCs to collaborate on equipment purchases. This would, in turn, deprive consumers of the benefits of innovation in BOC networks or unjustifiably delay their enjoyment of those benefits.

For the foregoing reasons, BOCs must continue to have the freedom to set their own equipment requirements, even if they work with other BOCs in doing so, without having to open the process to the equivalent of notice and comment rulemaking.

IV. DESIGN AND DEVELOPMENT ACTIVITIES ARE NOT "MANUFACTURING"

Section 273 makes explicit that "manufacturing" does not include design and development activities. It permits "close collaboration with any manufacturer of [CPE] or telecommunications equipment *during the design and development of*. . . such equipment"[1] as well as

[1] 47 U.S.C. § 273(b)(1) (emphasis added).

"*research activities* related to manufacturing."[2] However, TIA distorts this plain language and argues that "manufacturing" includes not only "fabrication," but also "design and development." TIA at 8. It relies on the assertion that "the MFJ manufacturing restriction was construed by the courts to encompass not only the fabrication of telecommunications equipment and CPE but also the design and development of hardware and software integral to such products." *Id.*

However, the court did not have before it plain language contradicting this interpretation of the term "manufacturing." Here, on the other hand, Section 273 explicitly exempts design and development, and research, activities from its scope. This plain language must supersede contrary interpretations by the court, and the term "manufacturing" should only include actual fabrication. *Accord* BellSouth at 2-3, US West at 8, SBC at 4 ("'Close collaboration' should be defined to include any activity required to produce a new product, except for the processing and fabrication of the hardware and software to a finished product.").

V. THE FCC SHOULD ADOPT A REALISTIC APPROACH TO BOC PROCUREMENT PRACTICES

As we assert above, none of Section 273's provisions should apply to a BOC not engaged in manufacturing. This argument extends to Section 273(e), which relates to BOC procurement practices. Even for BOCs actually engaged in manufacturing, the Commission should adopt a realistic approach to BOCs' procurement practices that 1) does not constrain BOCs from

[2] 47 U.S.C. § 273(b)(2)(A) (emphasis added). In the context of the MFJ, the term "research" was construed to include design and development. *See U.S. v. Western Electric Co.*, 675 F. Supp. 655, 663 n.36 (D.D.C. 1987), *aff'd*, 894 F.2d 1387 (D.C. Cir. 1990) (quoting favorably Department of Justice report referring to design and development activities as "*research* and development.") (emphasis added). Thus, even BOCs not engaged in collaborative design and development activities -- which are covered by Section 273(b)(1) -- are allowed to engage in design and development by virtue of the "research" provision in Section 273(b)(2)(A).

awarding contracts based on the best value, 2) does not require competitive bidding, and 3) limits the definition of "related person" in Section 273(e)(1))(B) -- related to a BOC's nondiscrimination obligation -- to BOC affiliates.

A. The Commission Should Not Constrain a BOC From Awarding Contracts Based on Securing the Best "Value"

The FCC should not adopt procurement rules that will preclude a BOC from awarding contracts to vendors who offer products and services at the best *value* -- a combination of price, quality, delivery and other commercial factors. The FCC should simply adopt Section 273(e)(2) -- which recognizes BOCs' right to make procurement decisions based on these factors -- without further elaboration.

Therefore, we agree with SBC that Section 273(e)(2) "requires BOCs to make 'procurement decisions and to award all supply contracts for equipment, services, and software on the basis of an objective assessment of price, quality, and other commercial factors.' As long as BOC purchasing decisions are based on an objective assessment of these factors, it cannot be found to have discriminated in violation of Section 273(e)(1)(B)." SBC at 21, quoting 47 U.S.C. § 273(e)(2). *See also* USWest at 25 (arguing that Act's requirement that a BOC make procurement decisions on the basis of an objective assessment of "price, quality, delivery, and other commercial factors," is self-explanatory and self-executing); Bell Atlantic and NYNEX at 20-21.

B. The Commission Should Not Construe Section 273 to Require Competitive Bidding of Contracts

We oppose an interpretation of Section 273(e)(1)(A) that would impose a competitive bidding requirement on the BOCs. As Ameritech observes, "the word 'consider' [in Section 273(e)(1)(A)] was deliberately chosen to exclude the requirement of a formal bidding process for the

procurement of every product, and no further expansion of the term is necessary or appropriate." *See also* SBC at 20 (urging Commission to give word "consider" its ordinary meaning).

Had Congress intended to require competitive bidding, it easily could have said so. Its use of the term "consider" reveals an intent to give BOCs discretion in contracting, so long as they rely on Section 273(e)(2)'s "price, quality, delivery and other commercial factors." TIA's call for complex "procurement plans" (TIA at 49), and other excessively regulatory solutions that stretch the term "consider" beyond its ordinary meaning, should be rejected.

C. The Commission Should Not Define "Related Person" To Extend the Section 273(e) "Nondiscrimination" Obligation Beyond a BOC's Relations With Its Affiliates

In our Opening Comments, we took exception to the Commission's definition of the term "related person" in Section 273(e), which provides that a BOC "may not discriminate in favor of equipment produced or supplied by an affiliate *or related person.*" The Commission proposed to extend a BOC's Section 273 non-discrimination obligations to parties with whom BOC has a contract, "with whom [it has] *some type of relationship*," or with whom it has a royalty agreement. *NPRM,* ¶ 607 (emphasis added). We urged that the term "related person" be defined coextensively with "affiliate."

In like manner, SBC asserted in its comments that "royalty arrangements and joint ventures with a non-affiliated manufacturer, in which the BOC has a clearly defined business relationship, should not constitute a 'related' person." SBC at 22. Similarly, Northern Telecom asserts that "the Commission should interpret 'related persons' narrowly and specifically so as not to preempt existing business arrangements that the BOCs have with suppliers. An appropriate definition would include all BOC affiliates and any entity in which a BOC has a controlling financial interest." NorTel at 16-17.

Even TIA, which opposes the BOC positions in many areas, concedes the term "related person" should be limited to suppliers "in which a BOC has a material financial interest that gives it a direct and continuing share of the supplier's business or revenues." TIA concedes that "the mere existence of a customer-supplier relationship between a particular supplier and a BOC would not in itself suffice to make the supplier a 'related person' for purposes of Section 273(e)." TIA at 50 & n.126. *See also* Ameritech at 32 (a manufacturer paying royalties to the BOC is not a "related person.").

The FCC's proposal to extend the term "related person" to cover any person or entity with which a BOC has "some type of relationship" clearly goes too far. This definition would extend the Section 273(e)(1)(B) nondiscrimination requirement to virtually anyone. It would spur an intolerable level of litigation by making every conceivable "relationship" (however trivial or ordinary) a basis for a discrimination claim. A BOC that is merely in contract with a supplier must be allowed to continue to contract with that supplier without being charged with Section 273 "discrimination."

Rather, the term "related person" should be limited to a BOC's affiliates and employees. As we reasoned in our Opening Comments, Section 273(e) imposes obligations not only on BOCs,[3] but on "any entity acting on [the BOC's] behalf." Because the term "affiliate" is often used in connection with the term "BOC" or "LEC," it makes sense that that term would also be used here. On the other hand, the term "affiliate" is not a term of art in connection with "entit[ies] acting on [a BOC's] behalf." It is logical for this reason, we believe, that Congress included the term "related person" to denote only parties affiliated with entities acting on a BOC's behalf.

[3] Again, we believe Section 273(e) also should apply only to manufacturing BOCs.

VI. WE AGREE WITH BELLCORE THAT SECTION 273 SHOULD NOT APPLY TO IT ONCE IT IS SOLD

Bellcore aptly observes that the BOCs are in the process of selling it, and that "after the sale . . . [it] should not be treated differently than [other independently-owned sources of the standards-related and certification services at issue in this proceeding] in terms of the application of Section 273(d) to activities." Bellcore at i. We agree, second Bellcore's comments in this regard, and urge rejection of TIA's comments to the contrary. TIA at 28-29 & 34.

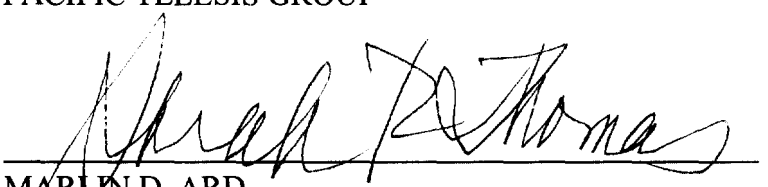
VII. CONCLUSION

In construing Section 273, the Commission should remember that Congress intended it as a "manufacturing" provision. If there is no "manufacturing" because a BOC chooses not to engage in such activity, Section 273 should be irrelevant to a BOC's activities. The Commission should take a similarly deregulatory approach to other provisions of Section 273, by 1) allowing BOCs to set necessary specifications for their equipment without having to open their decision-making process to a cumbersome and time consuming "notice and comment" process; 2) construing the term "manufacturing" narrowly to exclude design and development activities; 3) limiting the scope of the

nondiscrimination" provision; and 4) holding that Section 273(d) will not apply to Bellcore once it is sold.

Respectfully submitted,

PACIFIC TELESIS GROUP



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